GOVERNMENT OF INDIA
URBAN DEVELOPMENT AND POVERTY ALLEVATION
LOK SABHA

UNSTARRED QUESTION NO:3423
ANSWERED ON:20.03.2001
TAX FREE MUNICIPAL BONDS
SUKENDER REDDY GUTHA;SULTAN SALAHUDDIN OWAISI

Will the Minister of URBAN DEVELOPMENT AND POVERTY ALLEVATION be pleased to state:

(a) whether the Union Government have issued guidelines for Tax Free Municipal Bonds;

(b) if so, the details thereof;

(c) the purpose for which these bonds are to be floated by municipal bodies;

(d) whether these guidelines have been issued to the municipal bodies of all the State Governments and Union Territories;

(e) if so, whether these bonds are tax free and the interest accrued thereon is also exempted from tax;

(f) if so, the details thereof;

(g) the maximum limit of bonds for projected cost of a particular project;

(h) whether the Union Government have received any requests from various State Governments, particularly Andhra Pradesh for founding through Tax Free Municipal Bonds;

(i) if so, the details thereof; and

(j) the response of the Union Government thereto?

Answer

MINISTER OF STATE FOR URBAN DEVELOPMENT & POVERTY ALLEVIATION (SHRI BANDARU DATTATREYA)

(a)to(g): The guidelines have been issued on 8th February, 2001 for Tax Free Municipal Bonds. A copy of the guidelines is enclosed at Annexure.

(h)to(j): No proposal has yet been received by the Ministry of UrbanDevelopment & Poverty Alleviation from any State Government for issue of Tax Free Bond.

ANNEXURE REFERRED TO IN REPLY TO PART (a) TO (g) OF LOK SABHA USQ NO.3423 FOR 20.3.2001.

ANNEXURE

No. K-14011/41/96-UD.III
Government of India
Ministry of Urban Development & Poverty Alleviation

(Deptt. of Urban Development)

New Delhi, the February 8, 2001

OFFICE MEMORANDUM

Subject: Issue of Tax Free Municipal Bonds.

The Central Government has inserted a new clause (vii) to Section 10(15) of the Income Tax Act, 1961 vide Finance Act, 2000, whereby interest income from Bonds issued by local authorities are exempted from income tax.

2. Guidelines are hereby circulated for issue of Tax Free Municipal Bonds by the local governments/authorities. It is requested that these Guidelines may be widely circulated, to enable the State/Local Governments concerned to submit proposals to the Central Government i.e. Ministry of Urban Dev. & Poverty Alleviation for issue of Tax Free Municipal Bonds.

Sd/-

(S.K. Bhatnagar)
Under Secretary to the Govt. of India
Tel.3018682/Fax. 3015966

To

All the State Governments/ U.T. Governments
[By name to Secretary (Urban Dev.)/Secretary (Local Self Govt.)]

Copy to:

1. Ministry of Finance (Deptt. of Renevue), North Block, New Delhi [Smt. Deepa Krishnan, Director]

2. Ministry of Finance (Deptt. of Economic Affairs), North Block, New Delhi. Separate copies to Shri Ashok Lavasa, Jt. Secretary(ADB&I) and Shri Siddharth Behura, Joint Secretary.

3. Ministry of Finance (Deptt. of Economic Affairs), North Block, New Delhi [Shri B.S, Bhandari, Director (CM&ECB-I]

A copy of the Guidelines, duly vetted by the Ministry of Law, Justice & Company Affaris (Deptt. of Legal Affairs) is enclosed.

(S.K. Bhatnagar)
Under Secretary to the Govt. of India

GUIDELINES FOR ISSUE OF TAX FREE MUNICIPAL BONDS

1. Eligibile Issuers

The eligible issuers of Tax Free Municipal Bonds shall be:

i. Local-self Governments, other local authorities or public sector companies duly constituted under an Act of Parliament or State Legislature;

ii. Other local authorities constituted under relevant state government statutes like Water Supply and Sewerage Boards/Authorities, which are engaged in provision of any of the eligible purposes as listed under paragraph (2);

iii. Groups of local authorities/governments as defined under Sub-Section1
(i) and
(ii) above through a financial intermediary
such as a DFI or commercial bank.

iv. Provided the issuers mentioned at Clause
(i) and
(ii) are
covered under the defination of Section 2(36-A) of the Income Tax Act.

Section 2(36-A) of the Income Tax Act reads as under:

`public sector company` means any corporation established by or under any Central, State or Provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956 (1 of 1956);

Section 617 of Companies Act reads as under:

For the purposes of this Act, Government company means any company in which not less than fifty-one per cent of the paid up share-capital is held by the Central Government or by any State Government or Governments, or partly by one or more State Governments, and includes a company which is a subsidiary of a Government Company as thus defined.

2. Use of Funds Raised

The funds raised from Tax Free Municipal Bonds shall be used only for capital investments in urban infrastructture for providing one or more of the following:

i. Potable Water Supply;

ii. Sewerage or Sanitation;

iii. Drainage;

iv. Solid Waste Management;

v. Roads, Bridges and Flyovers; and

vi. Urban Transport (if this is a municipal function under

respective state legislation).

The capital investments shall be for the following purposes:

(a) setting up of new project(s);

(b) expansion, augmentation or improvements of the existing system.

3. Essential Pre-conditions

A. Project Development

a. The proceeds of the proposed issue shall be clearly earmarked for a defined project or a set of projects; b. Before the actual issuance of Tax Free Bonds, the following tasks shall be completed:

i. an investment plan for the project components indicating phasing and a financing plan approved by the local authority or the Board of the agency as the case may be;

ii. identification of the benchmarks for commencement and completion including the milestone dates for all the proposed components under the overall project(s);

iii. Pre-qualification of the bidders for the proposed project should be completed and final tender documents should have been issued to all prequalified bidders;

iv. The land required for the project should be in possession of the issuer and/or the process for land acquisition and other statutory clearances if any should have been initiated.

a. The issuers as specified in paragraph (1) above shall maintain a separate account of the amount raised from the Tax Free Municipal Bond, to be utilised only for the project related expenditure;

b. The issuers shall establish a separate Project Implementation Cell and designate a Project Officer who shall monitor the progress of the project(s) and be responsible for ensuring that the funds raised through Tax Free Municipal Bonds are utilised only for the project(s) for which the Bonds were issued.

4. Instrument, Maturing and Buy-back

a. The Tax Free Bonds should have a minimum maturity of 5 years. The issuers will have option to offer deep discount bonds or other financial innovations especially to enhance the tenor of the bond.

b. The issuers may have the option for buy-back arrangements of the face value of the bonds from any individual investor after a lock-in period of three years.

5. Nature of issue and Tax Benefits

a. The choice of raising the amount as a public issue or by private placement or a combination of both types will be left to the issuer;

b. Income by way of interest rate upto 10.50 per cent will be entitled to exemption from Income Tax under the Income Tax Act, 1961 without limits.

6. Ceiling on Amount of Tax Free Municipal Bonds for a Project

a. The amount of issue of bonds for the purposes listed under item(2) above will be approved on a case by case basis by the Ministry of Urban Development and Poverty Alleviation, Government of India. The maximum amount of Tax Free municipal Bonds as a percentage of the total project costs (excluding interest during construction) will be 33.3 per cent or Rs.50 crore whichever is lower;

b. The debt equity ratio for the project shall not exceed 3:1.

B. Financial Viability

a. The project(s) shall be fiancially viable; b. Financial viability here means that the project(s) should be able to generate a stream of revenue which should be sufficient to finance the project. c. The issuer shall create an Escrow account for debt servicing of bond proceeds with earmarked revenue. Earmarking of revenue through Escrow mechanism will be monitored by an independent. Trustee like the DFIs or the nationalised banks.

C. Other Conditions

a. The issuers will be subject to rules regarding borrowings under respective municipal legislation (as specified 1
(i)) in
respective states or other laws relating to total borrowing;

b:
i. The issuer shall further undertake to provide an additional debt covenant under which the Debt Service Coverage Ratio (DSCR) of at least 1.25 is maintained through out the tenor of the TAx Free Municipal bond.

ii. DSCR is defined as a ration of net income after meeting all the obligations and liabilities of the issuer except the long term debt obligations (principal and interest) to long term debt servicing obligations.

iii. For the purpose of estimating net income, the income and expenditure of the entire utility/Corporation may be considered instead of project specific renenues and expenditures.

iv. All State grants or transfers to the issuer should be

deposited into the escrow account and the Bond issue must clearly set forth the order of priority according to which the revenue generated by the enterprise will be allocated for various purposes.

v. Estimate of DSCR shall be based on realistic assumptions.

D. Project Account and Monitoring

In case of municipal authorities, the issuers shall at least contribute 20 per cent of the projects cost either from internal resources or other grants or a mix of the two.

7. Compulsory Credit Rating

It will be mandatory for the issuer to obtain an investment grade rating from an RBI approved and the reputed credit rating agency before the issuance of the Tax Free Municipal Bonds. The credit rating agency will carry out a due diligence process at the time of award of the initial rating to ensure that all the conditions mentioned in the Guidelines are met and would also monitor the same as part of its surveillance during the tenor of the Tax Free Municipal Bonds.

8. Legal and Administrative Requirement

a. The issuers shall adhere to all other applicable legal and administrative requirements which are in force from time to time;

b. Where a public issue is made, the issuer shall abide by the guidelines issued by the Securities and Exchange Board of India (SEBI)

9. The Competent Authorities to Grant Tax Exemption and Approval:

a. The Deptt. of Economic Affairs (DEA) will lay down the quantum of tax free Municipal Bonds to be issued during the financial year and inform the Ministry of Urban Development and Poverty Alleviation (MOUD&PA) of the quantum and any other regional or sectoral restrictions they may prescribe.

b. The Ministry of Urban Development and Poverty Alleviation

(MOUD&PA), Government of India shall be the nodal agency for processing the proposal for tax free Municipal Bonds. Teh MOUUD&PA will receive the applications for issue of Municipal Bonds and after processing the same will place before the Committee to be constituted hy it having representatives of DEA and the Central Board of Direct Taxes (CBDT). The Committee will forward its recommendations to the DEA, which will notify the specified Bonds in the Official Gazette with the approval of the Finance Minister.

c. The Municipal Bonds notified by the DEA in the Official Gazette shall be eligible for tax exemption under section 10(150

(vii) of the Income Tax-Act.

10. External Monitoring

With six months of the close of every financial year, the escrow account and the project account will be audited by a firm of Chartered Accounts appointed by the concerned State Urban Development Departments from a panel of Chartered Accounts approved by the C&AG and the fully complied audit report submitted to the MOUD&PA.

11. Listing of Bonds.

The Tax-Free bonds may be listed on the Stock Exchange.